BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Transport Rate Structure and Pricing	)	CC Docket No. 91-213
	)	
Usage of the Public Switched Network by Information Service and Internet Access Providers	)	CC Docket No. 96-263

REPLY COMMENTS OF TIME WARNER COMMUNICATIONS HOLDINGS, INC.

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February 14, 1997

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Time Warner Communications Holdings, Inc., ("TWComm"), by its attorneys, hereby submits its reply comments in response to the Commission's Notice of Proposed Rulemaking in the above-captioned proceeding.[1]

I. INTRODUCTION AND SUMMARY

The comments filed in response to the Notice underscore the critical importance of the Commission's decision in this proceeding. Any action (or inaction) the Commission takes in this docket will result in far-reaching consequences for the

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1 See Access Charge Reform, CC Docket Nos. 96-262, 94-1, 91-213, 96-263, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, FCC 96-488 (released December 24, 1996) ("Notice").

telecommunications industry and for consumers. TWComm is concerned that access charge reform is being considered primarily in light of its potential impact upon ILECs.[2] Undoubtedly, ILECs will experience the effects of the Commission's reforms. However, potential competitors, too, will be impacted by the Commission's decision. A failure by the Commission to promote competition and to prevent anticompetitive abuses would severely damage nascent competitive markets. Ineffective or delayed competitive entry combined with greater freedom for monopoly ILECs perversely would harm consumers under the 1996 Act. TWComm urges the Commission to consider this possibility when weighing the options for access charge reform.

TWComm confines its Reply Comments to responding to issues raised by other parties. Specifically:

- A market-based approach to access charge reform must avoid harming the development of competition and the interests of ILEC access customers. The market approach proposed by the Notice and the ILECs fails to protect adequately against anti-competitive ILEC incentives. ILEC requests for pricing flexibility in the absence of substantial competition must be rejected.

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2 The Commission should note the disastrous consequences that can attach to attempts to ignore market realities in order to retain revenue neutrality for ILECs. See Transport Rate Structure and Pricing, CC Docket No. 91-213, Report and Order and Further Notice of Proposed Rulemaking, 7 FCC Rcd 7006, 7023 at ¶ 34 (1992)("First Report and Order")("the interconnection charge would be priced residually as an initial matter so as to make transport charges as a whole under the new rate structure revenue neutral")(emphasis added). The TIC resulted from these efforts and the Commission's action was deemed arbitrary and capricious by the D.C. Circuit. Competitive Telecommunications Ass'n v. F.C.C., 87 F.3d 522, 532 (D.C. Cir. 1996).

- Ameritech's Loop/Port Recovery Charge proposal would insulate ILECs from competitive forces and would dampen the development of competition in the local and access markets. The Commission should dismiss the Ameritech proposal.

- Neither law nor economic theory nor sound public policy mandates the ILEC recovery of historic costs. The Commission should reject ILEC proposals for regulatory structures designed to guarantee historic cost recovery.

- The Commission must remove costs associated with tandem-switched transport from the TIC so that tandem-switched transport competition can develop.

- The Commission should avoid regulating CLEC terminating access in the absence of evidence that CLECs have actually overpriced such services.

II. THE MARKET-BASED APPROACH TO ACCESS CHARGE REFORM MUST NOT HARM THE DEVELOPMENT OF LOCAL ACCESS COMPETITION AND MUST ENSURE THAT ACCESS CUSTOMERS AND CONSUMERS ARE BENEFITED.[3]

TWComm supports a market-based approach to access charge reform, but not as initially proposed by the Commission,[4] and not as proposed by the ILEC interests filing comments in this proceeding.[5] TWComm believes that a market-based approach to access reform must condition ILEC pricing flexibility upon the presence of substantial competition in the provision of local access services; any approach that does not appropriately condition ILEC access pricing flexibility will squander the 1996 Act's promise of local telephone service competition and will

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3 This Section relates to Sections V.A and V.B of the Notice.

4 See Notice at ¶¶ 162-164.

5 See, e.g., USTA Comments at 25-35.

pose a significant threat of harm to ratepayers.[6] The market-based approach proposed by the Commission, modified as suggested by TWComm, will accomplish the objectives of the 1996 Act; the approach proposed by USTA and other ILEC interests simply will not.

With certain variations on the theme, ILEC commenters generally propose that the Commission provide ILECs essentially unrestricted pricing flexibility upon a showing that a given state has approved an interconnection agreement complying with sections 251 and 252 of the Act, or that a given state has approved a Statement of Generally Available Terms ("SGAT").[7] ILEC commenters also propose that the Commission revise the Part 69 price cap regulations applicable to switched access services subject to Phase I regulation to consolidate the baskets within

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6 See Appendix to TWComm Comments in which TWComm proposes a definition of the proper criteria for measuring substantial competition. TWComm recommends using the measurement criteria applied to AT&T for streamlining and pricing flexibility purposes, modified to account for the fundamental differences between AT&T and the ILECs regarding market power and bottleneck control. These criteria include an analysis of demand elasticity, supply elasticity and market share, with market share given the greatest weight. The LATA should serve as the relevant geographic market (which should include both intrastate and interstate services offered in that geographic area) and, subject to certain limitations, the existing price cap service categories could serve as the relevant product markets. The Commission must also consider the relative presence or absence of shared costs among products or geographic areas when the ILEC provides both competitive and non-competitive services in those categories.

7 See, e.g., Bell Atlantic and NYNEX Comments at 43; BellSouth Comments at 30; Southwestern Bell Comments at 26.

which such services fall. Such an approach will severely undercut the goals of the 1996 Act for the following reasons:

- The mere theoretical availability of unbundled elements does not demonstrate that the ILEC's access service offerings are subject to substantial competition;

- If pricing flexibility is granted in the absence of substantial competition, ILECs will have a reduced incentive to provide the degree of cooperation necessary for the development of local access competition;

- Revising the Part 69 price cap regulations to consolidate the baskets and service categories for switched access services will allow ILECs to deter competitive entry through cross-subsidization and strategic pricing; and

- Contrary to ILEC assertions, Commission precedent does not support granting pricing flexibility in the absence of substantial competition.

Finally, ILEC requests for forbearance for Special Access and Collocated Direct Trunked Transport should be rejected because competition for such services is not sufficient to warrant deregulation. Where competition does not justify such relief on a LATA-wide basis, forbearance will only enhance ILECs' ability to shift costs to consumers of less competitive services.

A. The Availability Of Unbundled Elements Does Not Provide A Sufficient Basis For Granting Pricing Flexibility.[8]

ILEC commenters justify their bid for unrestrained pricing flexibility in Phase I on the grounds that having an approved interconnection agreement or SGAT for the provision of unbundled elements ensures the removal of remaining entry barriers and will

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8 This Subsection relates to Section V.B of the Notice.

constrain the ability of ILECs to raise access rates.[9] This justification is without merit and the ILEC proposal should be rejected.

First, the mere availability of unbundled elements does not provide a sufficient basis for finding that an ILEC has effectively removed entry barriers. The fact that an interconnection agreement has been reached with a CLEC and approved by a state PUC does not indicate that the terms of the agreement will in fact be workable and implemented, much less allow the development of robust competition. The availability of a SGAT provides even less basis for concluding that entry barriers have been removed because the SGAT cannot account for the particular needs of a specific market entrant.

Moreover, because the methods by which an ILEC can inhibit the entry of local access competitors are difficult to detect, only the presence of substantial competition over time will indicate that entry barriers have been removed. Unless substantial competition is present, the Commission should have no confidence that the terms of interconnection are free of barriers to competition and market growth. As evidence of the removal of entry barriers, an interconnection agreement or SGAT is a step in the right direction and nothing more.

The availability of unbundled elements pursuant to interconnection agreements and SGATs provides no evidence of

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9 See USTA Comments at 27.

functional local access supply alternatives. An assessment of supply alternatives for local access must depend on an examination of the status of actual competitive effects, not future hopes. This is particularly crucial now, when local access competition likely will focus on a few limited services. If accepted as proof of supply alternatives, interconnection agreements or SGATs could be used to support pricing flexibility for all access services, not merely those subject to substantial competition.

Finally, the notion that an interconnection agreement or SGAT provides a reasonable restraint on the ability of ILECs to raise access rates is without merit. Whether or not unbundled elements will in fact prove to be a useful access alternative is, as yet, untested.[10] As a factual matter, under the Commission's rules, unbundled elements may only be used to offer access services to local telephone customers of the unbundled element purchaser. Thus, unbundled elements are only a reasonable substitute for access where the IXC also offers local telephone services to end users using unbundled elements. IXCs with no local telephone service ambitions and IXCs pursuing a facilities-based or resale local telephone entry strategy must undertake a new line of business or change their business plan in order to arbitrage access charges using unbundled elements.[11] Moreover,

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10 See Kwoka, John E., Jr., "Statement on LEC Price Cap Reform," at 16-17 (attached to MCI Comments) ("Kwoka").

11 It is, of course, by no means clear that the costs of entering the local telephone market through unbundled

IXCs using unbundled elements as a local telephone entry strategy cannot use such elements to internalize access for all subscribers unless they win all of their existing interexchange customers as local customers.

Further, as noted above, neither interconnection agreements nor SGATs, in and of themselves, provide any evidence that all access customers have reasonably available alternatives. More importantly, the availability of unbundled elements does not indicate the types of access services which are or will be offered using those elements; for the foreseeable future, some services and customers will have competitive alternatives while others will not. In these circumstances, the "potential" for access competition embodied in an interconnection agreement or SGAT is indeed a thin reed upon which to grant ILEC pricing flexibility.

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elements will allow access arbitrageurs to undercut ILEC access charges. If unbundled element prices prove to provide an irresistible price advantage, that merely demonstrates the need for rate restructuring and rebalancing, not the need for access charge pricing flexibility. As demonstrated in TWComm's Comments, existing ILEC price flexibility is sufficient to respond to access rates based on unbundled element prices where unbundled element prices recover the full TELRIC of the elements. See TWComm Comments at 28.

B. Granting ILECs Pricing Flexibility In The Absence Of Substantial, Facilities-Based Competition Will Remove The Incentive Necessary For ILEC Cooperation In The Removal Of The Local Bottleneck.[12]

ILEC commenters assert that Phase I pricing flexibility[13] should be available on a statewide (study area) basis where unbundled elements are available to competitors, whether through an approved interconnection agreement or through an approved SGAT. This proposal should be rejected. Granting ILECs unrestrained pricing flexibility before their services are subject to substantial, facilities-based competition will eliminate the incentive necessary to ensure ILEC cooperation and thereby will allow ILECs to prevent such competition from developing and maturing.

The Commission cannot simply allow competition in the provision of local services, and it cannot simply require that ILECs cooperate with this process. Rather, the Commission must provide ILECs a positive incentive to fully open the local access network to competition. This is because the ILECs possess nearly absolute control over their core markets. Most importantly, the ubiquity of the public switched network and its strategic importance empower the ILECs to control the success or failure of

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12 This Subsection relates to Section V.B of the Notice.

13 ILEC commenters suggest that Phase I pricing flexibility include the ability to deaverage switched access services by geographic area and class of customer, to offer volume and term discounts, to provide services based on contract rates, and to respond to Requests For Proposals ("RFPs"). See USTA Comments at 28.

competitive entry. As such, the standard for increased pricing flexibility must be higher than the Section 271 standard for long distance entry. Unlike with the long distance market, the ILECs have virtually 100 percent of the local exchange market and absolute control over the facilities needed by potential competitors to interconnect with the ubiquitous ILEC network.

Indeed, the ILECs can engage in violations of the Act that are difficult to detect. ILECs have historically proven adept at cloaking discrimination in the provision of bottleneck services with colorably legitimate business practices. ILECs can obtain a significant competitive advantage simply by withdrawing full cooperation from their competitors. Moreover, the Commission's Chief Economist has stated that "[t]hese problems are hard to regulate away, because the withdrawal of cooperation from rivals may be subtle, shifting, and temporary, but yet have real and permanent effects. . . ."[14] For these reasons, it is crucial that ILECs be given every incentive to provide full cooperation.

C. Modifying The Price Cap Rules For Switched Access Services Subject To Phase I Regulation Will Only Promote The ILECs' Ability To Cross-Subsidize And Engage In Strategic Pricing.[15]

Several ILEC commenters urge the Commission to revise the price cap rules for services subject to Phase I regulation.[16]

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14 Farrell, Joseph, "Creating Local Competition," 49 Federal Communications Law Journal 201, 207 (1996).

15 This Subsection relates to Section V.B of the Notice.

16 See USTA Comments at 27-28; BellSouth Comments at 31-32; Bell Atlantic and NYNEX Comments at 45-46.

Typically, these commenters propose that the Commission "simplify" the price cap scheme to consolidate baskets and service categories.[17] For example, USTA favors consolidating the following service categories into a single "Network Services" basket: Tandem Switching and Transport, Local Switching, Database Services, and Common Line.[18]

These proposals will serve only to facilitate the ILECs' ability to subsidize services subject to competition with rates from less competitive services, thereby frustrating the purpose of the price cap system. Indeed, the Commission has tried to guard against this problem in the past by grouping services subject to similar levels of competition in the same basket.[19] Even this process is imperfect, and ILECs currently possess the ability to cross-subsidize within baskets, limited only by the upper pricing bands.

The ILEC price cap consolidation proposal is particularly troubling when combined with Phase I pricing flexibility. ILECs will be able to strategically offer contract-based, volume or term discounts for services subject to a competitive entry threat and recover some or all of the revenue shortfall with rates for less competitive services.[20] Thus, consolidating services and

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17 See USTA Comments at 27-28, 50-54; BellSouth Comments at 31-32; Bell Atlantic and NYNEX Comments at 45-46.

18 See USTA Comments at 50.

19 See Notice at ¶ 216.

20 This does not necessarily imply that rate increases would be solely relied upon. Rather, ILECs could flow all

baskets will allow ILECs to impose static efficiency losses on consumers paying higher rates and dynamic efficiency losses on all customers by deterring competitive entry. Thus, revising the Commission's price cap rules would weaken an already imperfect protection against cross-subsidization.

D. USTA's Suggestion That The Commission's Treatment Of AT&T Supports The Application Of Pricing Flexibility Prior To Assessing The Status Of Competition Is Incorrect.[21]

USTA argues that ILECs should be allowed to offer volume and term discounts, provide service under contract tariffs and issue individual responses to RFPs in Phase I based in part on the assertion that "[t]he Commission adopted analogous regulatory reforms for AT&T prior to any determination regarding the status of competition in AT&T's markets."[22] While USTA offers no citation for this proposition, an examination of the Commission's decision granting AT&T the authority to offer service under contract-based tariffs[23] and other applicable precedent does not comport with USTA's assertion.

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productivity gains into rate reductions for competitive services and areas, while leaving consumers in non-competitive areas without the benefit of overall cost reductions. By contrast, all new entrant services are highly competitive. New entrants cannot maintain monopoly rate levels on any of their services.

21 This Subsection relates to Section V.B and V.C of the Notice.

22 USTA Comments at 49.

23 See Competition in the Interstate Interexchange Marketplace, CC Docket No. 90-132, Report and Order, 6 FCC Rcd 5880 (1991).

Before granting AT&T contract tariff authority, the Commission made a careful examination of AT&T's competitive situation. First, the Commission found that demand for business services was highly elastic.[24] Second, based on a review of analyses of traffic volumes and supply capacity, the Commission concluded that supply elasticities in the interstate interexchange market were high.[25] Third, the Commission found that AT&T had never exceeded the price cap ceiling for the relevant basket and had a market share in business services of approximately fifty percent.[26] The Commission noted that, combined with the high demand and supply elasticities of the market, a fifty percent market share was indicative of a highly competitive market.[27] As noted in TWComm's initial comments in this proceeding, Commission precedent firmly establishes that some showing of actual competition beyond mere entry is required before the Commission will grant pricing flexibility.[28]

Moreover, even if the Commission had not premised AT&T's contract tariff authority on a showing of competition, such a result would not support similar treatment of the ILECs. This is because the ILECs and post-divestiture AT&T simply are not

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24 See id. at ¶¶ 37, 40.

25 See id. at ¶ 46.

26 See id. at ¶¶ 49-50.

27 See id. at ¶ 51.

28 See TWComm Comments at 35, n.70.

similarly situated. Most significantly, ILECs possess control of bottleneck facilities. While the bottleneck is no longer legally protected, it is likely to persist in many areas for the foreseeable future and may persist indefinitely in many others.[29] Thus, an analysis of the ILECs' competitive situation is necessary and proper before granting relief similar to that granted AT&T.

E. The Commission Should Reject Forbearance Proposals For Special Access And Direct Trunked Transport Services.[30]

USTA and Southwestern Bell request that the Commission forbear from further regulation of Special Access and Collocated Direct Trunked Transport ("DTT") based on the assertion that competition exists for such services in certain high volume markets with high access line density.[31] Characterizing competition for Special Access as widespread, USTA seeks forbearance for all ILECs (presumably in all markets) rather than proceeding under individual petitions for forbearance.[32] The Commission should decline this request and continue to grant flexibility only where ILECs individually demonstrate the presence of substantial competition.

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29 See Kwoka at 17.

30 This Subsection relates to Section III.D and V.B of the Notice.

31 USTA Comments at 42-46; Southwestern Bell Comments at 19.

32 USTA Comments at 46.

Forbearance from regulation of Special Access and DTT should not be adopted by the Commission. First, competition for these services is not sufficient to warrant deregulation. At best, the data cited by USTA may demonstrate that Special Access services are competitive in certain geographic markets. The Commission has already granted appropriate pricing flexibility where ILECs have demonstrated that such services are subject to competition. On a going forward basis, the Commission should grant regulatory relief for Special Access and DTT where an ILEC demonstrates it is subject to substantial competition for such services, as described in the Appendix to TWComm's Comments.[33]

Relaxing regulation on a market-by-market basis will reduce the ILECs' ability to use pricing flexibility as a means of deterring competitive entry. Such an approach also will limit the extent to which ILECs can fund their responses to competition with Switched Access revenues. It is particularly important to safeguard against such cross-subsidization because Special Access and DTT are usually provisioned by ILECs using the same facilities as Switched Access. The common use of infrastructure by services subject to differing levels of competition provides a substantial opportunity for cost shifting. Forbearance would fail to provide any check on an ILEC's incentive or ability to cross-subsidize and, for this reason, the Commission should decline to adopt such proposals.

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33 See Appendix to TWComm Comments.

III. AMERITECH'S LOOP PORT RECOVERY CHARGE IS AN UNREASONABLE AND ANTICOMPETITIVE PROPOSAL.[34]

Ameritech has proposed that the Commission establish what it refers to as the "loop/port recovery" or "LPR" charge.[35] This charge would recover the costs allocated to the interstate rate base of the ILECs' loops and associated switching ports that are not recovered from the SLC.[36] Ameritech proposes that this charge should be transitioned from price caps to actual costs and should be recovered from interstate carriers on a "competitively neutral basis."[37] As the Commission no doubt recognizes, this is a totally unreasonable proposal.

Indeed, the notion that a tax should be imposed on interstate carriers (including those not utilizing ILEC exchange access) to pay for ILEC interstate loop costs not covered by the SLC is nothing short of astonishing. On a general level, the LPR would effectively ensure the survival of the local loop bottleneck by eliminating opportunities for low cost new entrants to compete in the provision of local loops. More specifically, the LPR is essentially a universal service mechanism for the

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34 This Section relates to Section III and Section V of the Notice.

35 See Ameritech Comments, Attachment A at 7.

36 See id.

37 Id.

ILECs only, and therefore violates Section 214(e).[38] Finally, the proposal to transition the LPR out of price caps so that the ILECs can recover actual loop and loop port costs also revives in full force the inefficiencies of rate of return regulation just at the time when Ameritech and other BOCs are attempting to enter the long distance business (and other price cap LECs are already in the long distance business) and other competitive businesses.

IV. THE ILEC "MAKE-WHOLE" PROPOSALS FOR "HISTORIC COST" RECOVERY ARE NOT SUSTAINABLE.[39]

TWComm has reservations about the purported existence and size of unrecovered historic costs in ILEC networks. Nonetheless, a definitive resolution of this issue is unnecessary. Even assuming that unrecovered ILEC historic costs remain, neither law nor policy compels the imposition of costs upon ratepayers and competitors to recover them.

USTA and the ILECs identify four areas in which historic costs allegedly have not been recovered: (1) the costs of regulation; (2) under-depreciation of plant; (3) the TIC component costs; and (4) costs overallocated to the interstate jurisdiction by the Commission's separations rules.[40] As explained below, the ILECs exaggerate the levels of unrecovered

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38 See 47 U.S.C. § 214(e)(any eligible common carrier "shall . . . receive universal service support")(emphasis added).

39 This Section relates to Section VII.B of the Notice.

40 See, e.g., USTA Comments at 68-79; PacTel Comments at 44-50; Southwestern Bell Comments at 40-52; Bell Atlantic and NYNEX Comments at 16-31.

historic costs. Moreover, they attempt to broaden the legal standard for regulatory confiscation as a way to persuade the Commission to mandate recovery.

Economics attaches no inherent value to historic cost recovery in a non-regulated environment: it is neither efficient nor inefficient. In this sense, the decision of a firm to recover its historic costs or to write them off its books is best left to the judgment of the individual firm. An economic value does attach, however, when historic cost recovery becomes a mandatory regulatory feature. To the extent that historic costs would not be recovered in a competitive market, the mandatory recovery of historic costs skews competition and requires ratepayers to pay more to allow an incumbent firm's historic cost recovery. Whether these consequences merit the cost recovery feature is a matter of regulatory policy; neither law nor economic theory mandate recovery.[41]

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41 It is self-evident that those historic costs resulting from ILEC inefficiency have no place in a discussion of regulatory recovery mechanisms. The recovery of inefficient ILEC expenditures is wholly the responsibility of ILEC shareholders. See, e.g., American Tel. and Tel. Co., Docket No. 19129, (Phase II), Phase II Final Decision and Order, 64 FCC2d 1, 49 at ¶ 118 (1977)("[E]xcessive investment is properly the responsibility and burden of the investor."); see also, 47 C.F.R. § 65.800 (indicating that the rate base shall include plant investments "used and useful in the efficient provision of interstate telecommunications services")(emphasis added).

A. The ILECs Are Not Owed Recovery Of Costs Of Regulation.[42]

The ILEC position considers the historic costs of regulation but fails to consider its attending enrichments. The Sidak and Spulber Affidavit attached to the USTA Comments discusses at length the "regulatory contract" and the "substantial capital expenditures" ILECs were required to incur as part of their obligation to serve.[43] Yet, it tells only half the story. The analysis neglects to recognize the profits, for both regulated and non-regulated services, earned as a result of these "substantial capital expenditures." Many ILEC vertical service offerings, the profitability of which have been heralded by the financial press,[44] are dependent upon the results of these capital expenditures. Combined with the "fair" rates of return allowed the ILECs for regulated use of the network (not to mention their substantial market shares), these profits represent historical financial advantages, not disadvantages, from the

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42 This Subsection relates to Section VII.B of the Notice.

43 See generally, Affidavit of J. Gregory Sidak and Daniel F. Spulber, Attachment 3 to USTA Comments, at 33-62.

44 See Gautum Naik, "Telecommunications: Baby Bells Profit by Tapping Phone Paranoia," Wall St. J., Sept. 3, 1996 at B1 (indicating that "the Bells and GTE Corp. rake in more than $4 billion a year on these new [vertical] services, and the take is growing" and that "the profit margins of 70% or more far exceed the less-than-10% profit that regional carriers typically get on basic phone service"); see also, Leslie Cauley, "Four Baby Bells Report Healthy Results," Wall St. J., Oct. 18, 1996 at B3 ("Four Baby Bells reported healthy profits for the third quarter, buoyed by strong consumer demand for second phone lines, enhanced services such as "Caller ID" and cellular fare")(emphasis added).

"regulatory contract."[45] Ratepayers need not be compelled to contribute any further to this false public debt.[46]

B. The ILEC Depreciation Reserve Deficiency Is Suspect.[47]

It is highly unlikely that ILECs retain legitimate interstate depreciation reserve deficiencies. Richard Lee's analysis demonstrates that ILECs may have a depreciation surplus rather than a depreciation deficiency.[48] The analysis demonstrates that the replacement cost of outside plant accounts is greater than the current net book value of such plant (although the opposite may be true for ILEC switches).[49] Because ILEC investment in outside plant is double that of its investment in switches, an ILEC's total plant replacement costs should be greater than its current net book value of the plant.[50] As the

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45 Moreover, if AT&T offers any example of post-monopoly expectations, the historical ILEC advantages will increase as a result of the market paradigm shift generated by the 1996 Act (insofar as ILECs abandon the erroneous notion that they are guaranteed specific rates of return on their operations).

46 Moreover, the conversion to price cap regulation in recent years was an implementation of ILEC requests to separate costs from rate levels to encourage efficiency. Their requests in this proceeding to reverse course and base rate levels upon underlying costs is inconsistent and would reinstitute the recovery methods (and attending inefficient incentives) of rate-of-return regulation.

47 This Subsection relates to Section VII.B. of the Notice.

48 Richard B. Lee, "Analysis of Local Exchange Carrier Depreciation Reserve Levels," Appendix C to AT&T Comments ("Lee Analysis").

49 See id. at 12.

50 See id.

analysis states, "[t]his would indicate a depreciation reserve surplus, not deficiency. . . ."[51] Moreover, market values of the RHCs are greater than their book values, indicating the absence of a significant depreciation reserve.[52] To understate the issue, the ILECs exaggerate the levels, if not the existence, of their interstate depreciation reserve deficiencies.

C. Unidentified TIC Costs Must Be Allocated On A Proportionate Basis.[53]

The Commission need not and should not abandon its preference for cost-based pricing when dismantling the Transport Interconnection Charge. The ILEC comments identify many of the cost components of the TIC.[54] Where identifiable, TIC components should be assigned to the appropriate cost-causative interstate switched access elements. Those remaining TIC components which ILECs claim result from overallocation of costs to the interstate jurisdiction should be addressed through the Commission's upcoming separations reform proceeding. Any remaining costs not identified should be phased out over a three- to five-year period.

Under no circumstances should ILECs be permitted to recover residual TIC components from the universal service fund. As

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51 Id.

52 See id.

53 This Subsection relates to Section III.E and Section VII.B of the Notice.

54 See PacTel Comments at 71-72; BellSouth Comments at 75-78; USTA Comments at 59.

TWComm indicated in its comments, to the extent that rates fail to recover the forward-looking costs of loop provisioning, the Joint Board's Recommended Decision allows for the proxy model to assess the appropriate reimbursement.[55] TIC cost recovery from universal service would allow an unreasonable double recovery of costs.

Finally, the Commission must dismiss the unreasonable ILEC suggestion that a separate recovery mechanism, such as bulk billing, be established to preserve ILEC revenue requirements previously recovered through the TIC.[56] Competition allows the generation of revenues; it does not require it. The ILECs are no longer exempt from this paradigm. Accordingly, the Commission should dismiss ILEC revenue requirement recovery proposals, which would reinstate the largely discredited rate base, rate-of-return regulatory structure and its attending harmful incentives.

D. The Commission Should Correct For Any Jurisdictional Cost Misallocation Through Separations Reform.[57]

With respect to the ILECs' stated need for separations reform, TWComm agrees: reform of the jurisdictional separations

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55 Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Recommended Decision, FCC 96J-3 at ¶ 270 (released Nov. 8, 1996)("We find that forward-looking economic costs should be used to determine the cost of providing universal service.").

56 See, e.g., Southwestern Bell Telephone Company Comments at 9 (advocating the implementation of a new "Public Policy" charge to recover, among other items, costs embedded in the TIC).

57 This Subsection relates to Section VII.B of the Notice.